NOESIS CAPITAL MANAGEMENT
A REGISTERED INVESTMENT ADVISOR

October 15, 2008

Dear Client:

Global events since mid-September will leave an indelible mark on the economic and financial history of the United States as well as other major countries. It may well be a few quarters until the next leg of the current business cycle can be viewed with adequate clarity, but that time will come and it is not too soon to begin planning for it, or at least thinking about it.

While investment strategies must include defensive considerations, it is important to also focus on longer range opportunities. Moreover, despite an abundance of negativity, the severity and duration of a possible recession are unclear. It is also important to note that commodity prices have fallen significantly which will reduce inflation prospects.

Recent economic news has been dismal, from a freeze-up of the credit markets creating serious questions about the stability of our financial system, weak employment data, declining manufacturing activity, plunging auto sales and softening exports – which had been a notable area of strength. To make matters worse, small businesses have had credit lines cut, or eliminated, and there are even reports that well qualified car buyers have been unable to get loans. All of this sounds horrendous, and it is, but there are many other factors to consider to form a balanced view of the outlook. While the panic is far from over and a prospective recession certainly does not provide much to cheer about, recent developments provide valid reasons to retain confidence in the viability of our banking system and financial markets.

The Troubled Asset Relief Program (TARP) was passed by the U.S. House of Representatives on Friday, October 3rd, and signed into law the same day. Although no one claims that this bill is even close to being flawless, and markets around the world expressed a lack of confidence, it is a strong statement that Washington is committed to supporting the financial system and avoiding a meltdown. There are many talented people working intensely on these problems and there are valid reasons to believe their efforts will be successful. Furthermore, it is important to bear in mind that this is not the only arrow in the government's quiver for fighting against economic weakness. Additional actions in monetary and fiscal policy could be used if deemed necessary with the policymakers' aggressiveness subject to their view of the severity of the economic outlook.

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We should not overlook the fact that private capital is willing to make huge commitments that obviously would not be considered if there was no sign of light at the end of the tunnel. Wells Fargo, for example, had agreed to buy Wachovia for $15.4 billion without any government involvement. Similarly, Warren Buffett recently made multi-billion dollar investments in Goldman Sachs and General Electric.

While the overall outlook remains ominous by any measure, current developments are encouraging steps towards rebuilding confidence in the U.S. financial system as well as those in other parts of the world. Moreover, evidence is beginning to appear, as mentioned above, indicating that some astute investors are perceiving opportunities in contrast to widespread fear.

While panic and the prospect of an economic recession are not helpful, last week's developments are important steps in restoring trust in our markets, as well as evidence that some bright people are replacing fear with a more optimistic outlook. This is certainly consistent with past business cycles, when equity markets began to recover before the economy hit bottom. In addition, the Fed lowered the Fed Funds Target Rate by 0.5% on October 8th, between meetings, which also was quite significant, and this action was joined by central banks around the world. This was particularly important since the European Central Bank, which raised rates as recently as July, finally recognized the risk of a slow down.

Many of you probably remember the old Wall Street adage attributed to Baron von Rothschild who supposedly said “buy when there is blood in the streets, even if some of it is yours.” This advice may be fine coming from someone with almost unlimited resources, but it is against most human instincts. Nevertheless, there may be some validity to what the Baron may have said and we should keep it in mind.

Consumer spending is weak and the holiday shopping season is not expected to show any pickup. Similarly, capital spending is getting weaker, most financial stocks are severely depressed and energy stocks, among others, are in a state of decline. We are carefully watching these sectors with the expectation that there may be some opportunities over the next few months.

We are also carefully watching our core holdings with the conviction that most have good earnings, strong balance sheets and business models with healthy prospects. If any of them show signs of falling short of these expectations they will be replaced.

FIXED INCOME UPDATE

Yields on treasury securities moved lower during the quarter, with the 3-month Treasury Bill yield slipping from 1.90% to 0.90% and the 10-year Treasury Note moving from 3.99% to 3.85%. The quarter has been a rollercoaster with income securities, in general,

showing more volatility than what has been seen in previous quarters, or in decades for that matter. We witnessed some astonishing events this past quarter. The Treasury intervened in Freddie Mac and Fannie Mae to stabilize their operations. Lehman Brothers filed for bankruptcy. The government bailed out AIG with a high interest rate two year loan and may need to break up the company's assets for the loan to be paid back. This was all capped by Congress' approval of a $700 billion program directed to stabilize asset prices. All of this activity has increased uncertainty and led banks and other financial intermediaries to be unwilling to lend funds even for short periods. However, we are optimistic that recent initiatives taken by the Fed and the Treasury should eventually ease our current problems in the financial markets.

Headline inflation, which includes food and energy, and core inflation are expected to move lower in the coming quarters primarily as result of a rising unemployment rate and declining commodity prices, especially oil which is down almost 40% from recent highs. In addition, other assets, such as stocks, credit sensitive bonds, real estate and securitized loans, to name a few, are experiencing deflation in this environment.

Given the current environment, we recently purchased a "AAA" rated bond issued by the Federal Farm Credit Bank (FFCB). This bond is attractive because it has little sensitivity to the credit tightness in the economy today. The FFCB supplies credit to the American agriculture sector and has the support of the U.S. government. The bond has a 4.88% coupon and a March 2028 maturity. We are unlikely to hold this security to maturity.

We are always available to discuss your portfolio and/or address any questions.

Sincerely,

Richard M. Brown, CFA
Chief Investment Strategist

Our most recent Form ADV, Part II is available upon request

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